

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: IOWA TELECOMMUNICATIONS SERVICES, INC., d/b/a IOWA TELECOM	DOCKET NO. RPU-02-4 (TF-02-224, TF-02-225, TF-02-226, TF-02-227)
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**ORDER ACCEPTING LATE-FILED EVIDENCE AND
MODIFYING FINAL DECISION AND ORDER**

(Issued June 13, 2003)

PROCEDURAL HISTORY

On May 24, 2002, Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom (Iowa Telecom), filed with the Utilities Board (Board) a proposal to increase and consolidate its prices for basic communications services (BCS) in all three of its Iowa service territories. Iowa Telecom also proposed to add language to its tariff that would allow it to reduce prices in selected exchanges in response to competition. A request for temporary authority to increase rates was also filed and granted. A hearing was conducted September 4 through 6, 2002.

The Board issued its "Final Decision And Order" (Final Decision) on December 26, 2002. The Board denied Iowa Telecom's requested price increases. However, the Board approved Iowa Telecom's proposal to consolidate its prices among the three service territories. The Board allowed Iowa Telecom a 3 percent overall revenue increase to cover the cost of price consolidation. The order also

allowed Iowa Telecom to file tariff sheets adding its proposed competitive-response pricing flexibility language to its price regulation requirements. The Board also required Iowa Telecom to submit a plan to refund to its customers the difference between the allowed rate increase and the temporary rates in place during the time of the docket.

On January 14, 2003, Coon Rapids Municipal Communications Utility, Grundy Center Municipal Communications Utility, Harlan Municipal Utilities, Reinbeck Municipal Telecommunications Utility, Manning Municipal Communication and Television System Utility, and The Community Cable Television Agency of O'Brien County, d/b/a The Community Agency and TCA, on behalf of the Cities of Hartley, Paullina, and Primghar only (collectively, the Municipal CLEC Group), intervenors in the docket, filed an "Application for Rehearing and Clarification of Order."

Iowa Telecom filed an "Application for Rehearing and Stay" on January 15, 2003. The Municipal CLEC Group, the Iowa Association of Municipal Utilities (IAMU), and the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed timely responses to the application for rehearing.

On January 24, 2003, the Board issued an order granting Iowa Telecom's request for a stay of Ordering Clause Nos. 2, 3, and 4 from the Board's Final Decision and, on February 12, 2003, the Board issued an order granting rehearing for purposes of further consideration.

REHEARING REQUEST BY IOWA TELECOM

Summary of Iowa Telecom's Position

Iowa Telecom believes significant aspects of its proposal for a rate increase and pricing flexibility in competitive exchanges were not understood by the Board.

(Application, p. 2.) Iowa Telecom states the following points in its application for rehearing:

- Iowa Telecom believes it may have created some misimpressions with the Board regarding Iowa Telecom's financial situation. Iowa Telecom is not in financial distress and has always met its financial obligations.
- Iowa Telecom has an excellent relationship with its lenders. As evidence, Iowa Telecom submitted an affidavit from Mr. Larry Zawalick, Senior Vice President of the Rural Telephone Finance Cooperative (RTFC), describing his supportive view of Iowa Telecom's financial condition.
- Iowa Telecom provided a commitment to spend every dollar of net proceeds from the proposed rate increase to fund capital expenditures and begin implementation of its Network Improvement Plan. Iowa Telecom states that none of the increase in revenue will be used to pay interest, principal on debt, or dividends.
- The Board's decision will slow the pace of advanced telecommunication services deployment throughout Iowa. Iowa Telecom is committed to providing its customers with good service and has made major

improvements in its operations since it acquired GTE's Iowa operations, to the benefit of its customers and the economic development efforts of the communities it serves.

- The Legislature enacted Senate File 429 (SF 429) in the 2002 Session to allow Iowa Telecom the opportunity to increase its rates. Iowa Telecom believes the only standard under SF 429 for approving a rate increase is that the increase must be reasonable and that the four criteria for determining reasonableness are rate consolidation, the impact of competition, the ability to attract capital, and the deployment of advanced services. Iowa Telecom believes the Board based its determination largely on the GTE acquisition approval hearing, the Board's opinions about the terms of the original deal, and Iowa Telecom's experience in certain areas relative to its original projections. Iowa Telecom states that all this information was known to the Legislature when it enacted SF 429.
- SF 429 contemplates rate consolidation as a basis for finding reasonableness and at the same time prohibits the lowering of any rates. Iowa Telecom asserts the resulting legislative direction is that any rate consolidation would not be revenue-neutral, but instead would have to increase revenues. Iowa Telecom states that the Board mistakenly substituted the word "revenue" for "rate" in interpreting the statute as allowing the lowering of rates in an overall revenue-neutral

manner. Iowa Telecom asserts it is reasonable to raise all its rates to the highest rate it has historically charged in any of its exchanges.

- Since SF 429 prohibits a return to rate-base, rate-of-return regulation, Iowa Telecom did not file a cost study, based on its belief that one was not required or expected. Iowa Telecom states that no party took exception to the historical financial information it provided. Iowa Telecom also believes that since the statute precludes increases in access charges, any shortfall in earnings must be borne by the end users.
- SF 429 eliminated the 2 percent productivity factor for Iowa Telecom and Iowa Telecom believes it is entitled to go back to last year and claim the 2 percent inflationary adjustment. Iowa Telecom states that there is nothing in the statute that restricts the number of times in a year that rates can be raised.
- SF 429 allows for the Board to make reasonable modifications to any rate increase proposed by Iowa Telecom. Therefore, Iowa Telecom requests that the Board use its power under this provision to give further consideration to what is fair to Iowa Telecom. At a minimum, Iowa Telecom asks the Board to modify the proposal to the extent necessary to allow the fullest rate increase deemed “reasonable” in accord with SF 429.

(Application, pp. 3-10.) Additional points brought up by Iowa Telecom in its application include:

- Iowa Telecom argues that the Board misinterpreted (Application, pp. 16-22) and misapplied (Application, pp. 22-27) the statutory provisions of SF 429.
- Iowa Telecom insists that it has met each of the four criteria for determining the reasonableness of the proposed increases. (Application, pp. 28-33.)
- Iowa Telecom believes the Board made other improper conclusions regarding Iowa Telecom's forecasts and assumptions relating to access lines, non-basic rate increases, and minutes of use data. (Application, pp. 34-37.)
- Iowa Telecom states that it did not present inconsistent positions at the Logan public meeting. (Application, p. 37.)
- Iowa Telecom asks that the Board accept its proposal to not increase rates in competitive exchanges. (Application, p. 38.)

Summary of the Municipal CLEC Group's Position

The Municipal CLEC Group states the following in its resistance to Iowa Telecom's request for rehearing:

- The Board demonstrated its full understanding of Iowa Telecom's case in its very first finding of fact: "Iowa Telecom proposes to make its

customers pay for its own mistakes. The Board rejects that proposal.”

The Municipal CLEC Group goes on to say that Iowa Telecom did not prove its case and it now seeks rehearing to try again with evidence that was not previously presented, but could have been. The Municipal CLEC Group points out that the purpose of rehearing is to correct errors of law or fact, not to provide an opportunity to try a new case.

- That Iowa Telecom’s application for rehearing is inconsistent because it states on page two that Iowa Telecom is “poverty stricken” and states on pages three and four that Iowa Telecom is “financially vigorous”.
- That Iowa Telecom’s new commitment to spend rate-increase revenues on network improvements leaves it free to spend all the money in competitive exchanges at the expense of captive customers in monopoly exchanges.
- That Iowa Telecom admitted it wanted to reduce rates in duopoly exchanges and fund network improvements in those exchanges from rate increases in its monopoly exchanges.
- That Iowa Telecom catalogs its achievements in network improvements already accomplished using its present rates but offers no explanation why these improvements must now cease unless Iowa Telecom has free rein to engage in predatory pricing.

- That Iowa Telecom's new proposal to raise all of its rates to the highest rate historically charged in any exchange is not what Iowa Telecom proposed in its rate application.
- That Iowa Telecom's belief that since the statute precludes increases in access charges, any shortfall in earnings must be borne by the end users, is the same as saying there is no obligation by the investor-owned utility to control costs or otherwise exercise fiscal prudence. The Municipal CLEC Group continues by arguing that if such a law did exist, it would guarantee every investor a favorable return regardless of how high utility rates needed to be raised to offset the company's past imprudence.

(Resistance to Rehearing, pp. 1-7.)

Summary of IAMU's Position

IAMU states the following in its objection to Iowa Telecom's request for rehearing:

- If Iowa Telecom truly believes that "from the point of view of all parties to this proceeding, and even the Board, the Order does not advance the telecommunications needs of rural Iowa,"¹ then there is no justification for granting Iowa Telecom's request to reopen the record to admit the

¹ Iowa Telecom, *Application for Rehearing and Stay*, p. 2

Affidavit of Mr. Larry Zawalick. The IAMU objects to the proposed reopening of the record as unjustified by Iowa Telecom's own argument and as violative of fundamental due process rights unless completed with rights of discovery and possible cross-examination.

- SF 429 requires that the Board "consider" the four listed factors in determining the reasonableness of a price increase request, but also makes it clear the Board is "not limited to" these four factors.
- Iowa Telecom's "Commitment to Deployment of Advanced Services" is just another way for Iowa Telecom to distance itself from the facts found in this case by saying, in effect, that Iowa Telecom does not care how things appear to the Board, Iowa Telecom knows it can do this. The IAMU also questions the Board's ability to enforce the commitment in the future.

(Objection, pp. 1-2.)

Summary of Consumer Advocate's Position

Consumer Advocate makes the following points in its answer to Iowa Telecom's request for rehearing:

- Consumer Advocate notes that Iowa Telecom has not explained why the new evidence it attached to its rehearing application was not offered with Iowa Telecom's previous testimony and exhibits or in response to the Board's requests for supplemental information. Consumer

Advocate states that Iowa Telecom has not demonstrated that the new evidence arose since the final order was issued. (Answer, p. 1.)

- If the Board is to consider Iowa Telecom's new evidence, due process requires parties be afforded an opportunity to conduct discovery, offer additional evidence, and cross-examine witnesses prior to a Board decision on rehearing. (Answer, p. 2.)
- Nothing in SF 429 can be read as meaning Iowa Telecom is to receive a 2 percent BCS price increase on or after April 4, 2002, in addition to its last previous inflation-based BCS price increase but not for all previous inflation-based BCS price changes of Iowa Telecom and its predecessor. (Answer, pp. 2-4.)
- With regard to rate consolidation, Consumer Advocate agrees with Iowa Telecom that the Board's interpretation of § 476.97(11)"h" essentially substitutes the term "revenues" for "rates" and that the Board is prohibited by statute from requiring Iowa Telecom to lower its existing rates for any of its basic services. While Iowa Telecom suggests the Board correct its ruling by allowing those rates currently below the newly-computed revenue-neutral rates to be increased without offsetting decreases in those rates currently above the newly-computed revenue-neutral rates, Consumer Advocate suggests that rather than allowing Iowa Telecom to collect substantial additional revenue in the guise of a partial rate consolidation, the Board should reconsider

whether rate consolidation should be pursued at all and whether the 3 percent increase tied to rate consolidation is warranted. (Answer, pp. 4-6.)

- Iowa Telecom contends the mere existence of adverse economic impacts from competition justifies its proposed monopoly price increases under SF 429. Consumer Advocate states that the statute directs the Board to “consider” the impact of competition but does not direct the Board to approve price increases in monopoly exchanges to maintain Iowa Telecom’s revenues. That is the essence of monopoly behavior: compete where necessary and charge captive customers what the market will bear. The Legislature has not endorsed monopoly behavior as a public policy objective. (Answer, pp. 6-7.)
- The Board engaged in a detailed analysis of the evidence before concluding the proposed price increase would not significantly improve Iowa Telecom’s ability to attract capital. The Board did not err in its conclusion. (Answer, pp. 8-9.)
- The Board did not err in its analysis of Iowa Telecom’s financial data and its conclusion that the proposed price increase would not have a significant impact on Iowa Telecom’s ability to deploy advanced telecommunications services. (Answer, pp. 9-10.)
- Iowa Telecom misconstrues Consumer Advocate’s position on the need for cost evidence. Consumer Advocate argued prices set pursuant to

Iowa Code § 476.97(11)"h"(2), as amended by SF 429, are not to be judged using a revenue requirement calculated in rate-base, rate-of-return regulation. Consumer Advocate did not argue that costs are irrelevant to the Board's determination of reasonable prices for Iowa Telecom or that SF 429 eliminated or prohibited consideration of the cost incurred to provide service in the determination of a "reasonable" price for the service. (Answer, pp. 10-12.)

ANALYSIS

Nothing in Iowa Telecom's request for rehearing raises significant questions concerning the Board's overall analysis of Iowa Telecom's original testimony, exhibits, and other information. The Board based its analysis of the original evidence on the new statutory factors in SF 429; the Board's analysis regarding Iowa Telecom's overall price increase proposal and the effect of the repeal of the productivity factor will not be changed on rehearing. The Board will, however, address certain matters raised in Iowa Telecom's application for rehearing and will modify the Final Decision with respect to rate consolidation.

In its application for rehearing, Iowa Telecom included four submissions of new evidence: an affidavit from Lawrence Zawalick, Senior Vice-President of the Rural Telephone Finance Cooperative (RTFC); a Network Capital Commitment; a Capital Reconciliation - Projected Use of Proceeds exhibit; and a Preferred Stock Redemption exhibit. The Board will grant Iowa Telecom's request that these four

items of additional evidence be admitted to the record, but, as discussed below, the Board finds that they do not compel a change in the Board's Final Decision.

Mr. Zawalick's affidavit states that Iowa Telecom's projections show that even without a price increase, Iowa Telecom will be able to make its debt payments when due but will not be able to satisfy certain non-monetary financial covenants required by its credit agreement. (Affidavit at 4.) The basis for his statement is that he is "generally" aware of Iowa Telecom's past and current financial condition. (Affidavit at 2.) Mr. Zawalick says he has reviewed Iowa Telecom's financial statements and its projections and in making his statement he is relying on Iowa Telecom's underlying assumptions set forth in its projections. (Affidavit at 3.) Thus, his opinion suffers from the same flaws and issues as Iowa Telecom's baseline assumptions and the accuracy of Iowa Telecom's projections, both past and present, all as described in the Final Decision. The Board finds that Mr. Zawalick's affidavit is cumulative, at best, and does not provide a basis for changing anything in the Final Decision.

In its Network Capital Commitment document, Iowa Telecom states that the annual additional revenues (defined in the document in a manner that appears to allow investment a year in arrears) resulting from any increased rates approved in this docket will be expended on its Network Improvement Plan for an initial period of five years. In the same paragraph, however, Iowa Telecom states that it reserves the right to amend the Network Improvement Plan to reflect market, technological, or other changes.

In the next paragraph, Iowa Telecom states that the plan will terminate if, among other things, Iowa Telecom expends a cumulative sum equal to \$110 million, reduced proportionately to reflect future access line changes since Iowa Telecom's filing in this proceeding. Then, in the final paragraph Iowa Telecom states that the commitment may be waived or modified by the Board upon request by Iowa Telecom. Given these qualifications and time limitations, the Board concludes that Iowa Telecom's Network Capital Commitment is similar to Iowa Telecom's proposed Network Improvement Plan, in that both documents are based on good intentions but both lack solid commitment.

Moreover, the projects described in the Network Improvement Plan cannot all be characterized as being related to the provision of advanced services. Many of the projects are more fairly characterized as infrastructure maintenance and upgrades that probably should have occurred some time ago. These catch-up projects cannot be described as advanced services.

Finally, the Board understands the Municipal CLEC Group's concern that Iowa Telecom's new commitment would leave the company free to raise rates in monopoly exchanges in order to spend the increased revenues in competitive exchanges. This would amount to subsidized competition in a few exchanges at the expense of the customers who have no real choice. This would be an unacceptable result and does not provide a basis for changing the Board's Final Decision.

As for the Capital Reconciliation - Projected Use of Proceeds exhibit and the Preferred Stock Redemption exhibit, these are simply rearrangements of information

already presented in previously submitted exhibits and testimony. Neither provides a basis for any new conclusions or revised decisions.

Iowa Telecom's argument that the Board, through its decision, is slowing the pace of advanced telecommunications services deployment in Iowa is without merit. Iowa Telecom, throughout this case, has justified its proposed increases with the phrase "advanced services," but, as discussed in the Final Decision, Iowa Telecom's own witnesses admitted that advanced services are the last in line to benefit from any new funds the company might have received as a result of this docket. The Board's decision does not slow the pace of deployment when the alternative decision (granting Iowa Telecom's proposed price increases) would not be likely to result in faster deployment.

In the Final Decision, the Board considered Iowa Telecom's arguments in favor of rate consolidation and agreed that consolidation would be an overall benefit to Iowa Telecom and its customers. However, the Board directed Iowa Telecom to consolidate rates in a revenue-neutral manner, rather than by increasing rates in the manner proposed. In doing so, the Board anticipated that its interpretation of the price regulation statute might be the subject of some debate. (Final Decision, pp. 25-26.) That anticipation has come to pass, as both Iowa Telecom and Consumer Advocate have taken issue with the Board's statutory interpretation.

The Board continues to believe that rate consolidation is in the best interests of Iowa Telecom and its customers, so long as it is done on a revenue-neutral basis. However, the Board understands the parties' position regarding the proper

interpretation of § 476.97(11)"h" and the Board believes the costs and delays associated with litigating this issue might very well exceed the benefits. Therefore, while the Board does not necessarily accept the interpretation of the statute advanced by Iowa Telecom and Consumer Advocate, the Board will revise the Final Decision to make rate consolidation optional, rather than mandatory. Iowa Telecom may propose a revenue-neutral consolidation of the basic communications service prices in its three pricing zones, but is not required to do so.

The Board notes that the 3 percent revenue increase granted by the Board to Iowa Telecom in the Final Decision was intended to defray the costs associated with the revenue-neutral rate consolidation. Should Iowa Telecom decide not to pursue consolidation on a voluntary basis within a reasonable time after the issuance of this order, it will not be permitted to implement the rate increase. The Board will require that Iowa Telecom make its decision no later than 60 days after the date of this order.

REHEARING REQUEST BY THE MUNICIPAL CLEC GROUP

Summary of the Municipal CLEC Group's Position

The Municipal CLEC Group challenges the Board's approval of Iowa Telecom's proposed revision of its price regulation provisions to allow Iowa Telecom to reduce prices in response to competition. The Municipal CLEC Group argues that if Iowa Telecom were to file a proposed tariff revision for a price reduction to respond to competition, a municipal CLEC or other interested party that is competing with Iowa Telecom in the relevant exchange might not notice the filing until the ten days

allowed for objection has passed. The Municipal CLEC Group asserts that municipal CLECs and other interested parties should not be burdened with reviewing every Iowa Telecom tariff filing in order to ascertain whether it contains a competitive proposal that may affect them.

The Municipal CLEC Group asks that the Board modify its Final Decision to require Iowa Telecom to provide municipals or other interested parties, at Iowa Telecom's expense, a full copy of any application to the Board relative to any competitive response price adjustments, along with the appropriate cost studies and other related information that justify the proposal.

Summary of Iowa Telecom's Position

Iowa Telecom states it has no objection to providing a copy of any rate decrease proposal to affected competing local exchanger carriers as long as the appropriate confidentiality agreement is in place. Iowa Telecom states it will include provisions for notice in its tariff filing. Iowa Telecom did not respond to the Municipal CLEC Group's request for cost studies and other information.

ANALYSIS

The Board believes the Municipal CLEC Group's request is reasonable and that Iowa Telecom's response shows a willingness to work with the Municipal CLEC Group to allay its concerns regarding notice. The Board will allow Iowa Telecom to include in its proposal such notice provisions as Iowa Telecom believes to be

reasonable. Any interested person who believes Iowa Telecom's proposal is unreasonable may file an objection at that time.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. Iowa Telecom's "Application For Rehearing," filed in this docket on January 15, 2003, is granted with respect to rate consolidation and denied with respect to all other issues raised therein. Ordering Clause No. 2 from the "Final Decision And Order" issued December 26, 2002, is amended to read as follows:

Within 60 days of the date of this order, Iowa Telecom may elect to file proposed tariff sheets for a revenue-neutral rate consolidation of all rates that currently differ among the rate zones (other than Extended Area Service rates or similar exchange-based rates), with all supporting workpapers. If Iowa Telecom chooses to consolidate its rates, the tariffs should reflect a 3 percent revenue increase for consolidated rates and a 1.06 percent price adjustment for all BCS prices. The rate consolidation calculations should first be performed without the 3 percent revenue increase for the consolidated rates or the 1.06 percent increase for BCS prices, which should then be added as successive calculations.

2. Iowa Telecom's request for admission of the four late-filed documents, identified as an affidavit from Lawrence Zawalick, Senior Vice-President of the Rural Telephone Finance Cooperative, a Network Capital Commitment, a Capital Reconciliation - Projected Use of Proceeds exhibit, and a Preferred Stock Redemption exhibit is granted.

3. The "Application For Rehearing And Clarification Of Order" filed January 14, 2003, by the Municipal CLEC Group is denied.

4. The stay that was entered on January 24, 2003, of Ordering Clause Nos. 2 (as modified above), 3, and 4 of the "Final Decision And Order" issued on December 26, 2002, is lifted. The time periods provided in Ordering Clause Nos. 3 and 4 shall be calculated from the date of this order.

5. Motions and objections not previously granted or sustained are denied or overruled. Any argument not specifically addressed in this order is rejected either as not supported by the evidence or as not being of sufficient persuasiveness to warrant comment.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 13th day of June, 2003.